THE PANIC AND THE PRESENT DEPRESSION

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To accept too freely the theory of periodicity of panics is apt to make us fatalists and careless of our methods and laws. It is safer and more helpful to assume that each recurring panic has its own special causes and then to endeavor to ascertain these causes. Each panic teaches us something new and this accumulating experience should in time enable us to prolong the interval of recurrence if not eventually to prevent the recurrence entirely, just as epidemics of disease, formerly thought inevitable, are now prevented.

In connection with the panic of 1907 it is difficult to discover any widespread speculation or overproduction. An examination of stock exchange lists shows that the highest quotations for many leading railroad stocks, such as the Pennsylvania, Louisville and Nashville, Northern Pacific, Chicago and Northwestern, Denver and Rio Grande, Missouri Pacific, New York Central, New York, New Haven and Hartford, and Texas and Pacific, were recorded in 1901-02. From that time down to the panic of 1907—a period of five years—there occurred a considerable shrinkage of market value in the face of increasing earnings.

Overproduction we find in a few commodities, such as copper and lumber, but the list of such commodities is short.

Another recognized cause of panics is large investments in securities which are not immediately productive, such as was the building of the trans-continental railways at a time when there was little business for them. Have we witnessed any such phenomenon in connection with the recent panic? The incorporation of private industries and the listing of their securities on the exchange effect not a transformation of circulating capital into fixed capital, but rather a transfer (when the securities are marketed) of capital from the hands of one set of men to another. Increase of railroad trackage and cars, and improvements of terminal facilities, cannot

be put in the category referred to, because, until the panic came on, the business was waiting and these improvements were immediately productive. The calamitous fire and earthquake losses of the past few years, coming as they did when labor was fully employed, must of course be regarded as diminishing productive capital. For the time being we must likewise so regard the Panama Canal and the uncompleted tunnels entering New York. But where capital is concerned the recuperative process is quite rapid. Not all the happenings referred to came together and, moreover, they acted upon, all told, such a small proportion of our vast working capital that they could have had but little effect in the direction indicated.

To explain the panic of 1907 we are forced, then, to look for causes other than the usual causes of panics. One of them we find in the strain placed by legitimate business enterprise upon the world's money supply, a strain due largely to the great opportunities of our day. For this difficulty there is no visible remedy. To endeavor to find a substitute for money in something not limited by nature is to court trouble.

But the panic was largely centered in our own country and its origin must be sought principally in local conditions. Turning to them, there immediately appears as chief among them the attitude of the federal and state governments toward a most important industry, namely, the railroads. It is probable that the attack on the railroads was the most important single factor in producing a state of mind which made possible the panic of 1907. Unquestionably grave abuses existed, but these abuses may be classed largely under the head of conduct and were unconnected with the question of reasonable rates. The people were suffering from inadequate facilities more than from high charges. They were suffering from discrimination, which favored particular interests. The interest of the public lay distinctly in the direction of permitting the railroads to continue prosperous and then forcing them by law to make use of their profits to improve the service. In proceeding to attack railroad earnings we simply postponed the day of needed improvements, for the double reason that when earnings are inadequate the railroads can neither make improvements out of surplus earnings nor command sufficient confidence in their future prospects to enable them to borrow. If this reasoning be correct, it follows that one of the effective steps to recovery

is to change the public attitude toward railroads, to let them earn money and force them to make the proper use of that money.

The next step in bowling over the investor, and with him the laborer and the public generally, was the extravagant fine on a single industrial trust. A fine such as that imposed on the Standard Oil Company is out of keeping with the spirit of modern law, which is remedial, seeking cure and prevention, and subordinating the idea of retribution and revenge. The heads of these big corporations have frequently been termed knaves; they have seldom been charged with being fools. A fine the mere fraction of that actually imposed, together with an indication of what the maximum fine might have been on all the counts, would have demonstrated effectively to its managers the power of the government to ruin the Standard Oil Company if it failed to obey the law, and the desired end would have been attained without such disastrous consequences to the stockholder and the public.

The remedy for the abuses of industrial trusts probably lies in the direction of federal control, control through license. The moment corporations are required to register under a federal statute, the government may require certain information of them, and the possibility of great reform at once appears. When attended by publicity, compulsory investigation into illegal and unjust practices tends not only to correct the illegal practices, but the unjust practices as well, and that without resort to proceedings in a court of law or even in a court of arbitration. Possibly nothing but the knowledge that these corporations can be controlled by the federal government and are being controlled by it will stop the popular attacks on them.

What applies to the industrial trusts in this connection applies equally to the railroads, although here the federal government might possibly go a step further and resort to actual incorporation of interstate railroads under federal law as distinguished from the mere licensing of industrial trusts. It may find it wise and even necessary to do more than control the practices of the railroads, to interfere, in fact, with their actual operation by insisting on improvement of the service. If the government assumes such a position, of course railroad earnings must not be interfered with.

The recent decision of the Supreme Court declaring Minnesota and North Carolina rate laws unconstitutional because confiscatory

is cold comfort for the reason that if the state and federal governments are to be allowed to proceed against the railroads to the point of confiscation it leaves but little for the investor to look forward to.[1]

Another potent cause of the panic, a cause which has been generally recognized, is the inelasticity of our currency. This subject has been dealt with quite fully before this body and elsewhere during the past few months, and what I have to say to-day is simply by way of supplementing that discussion.

[1]At the Chicago trust conference in October last I had occasion to deal with this subject as follows:

Let our legislators see that where there is a single track to-day a double track be laid, that existing double tracks grow to four, that grade crossings be abolished, cars multiplied, terminal facilities increased, that the penalty of men's stupidity in living in such numbers under the insufferable conditions that prevail in our great cities be somewhat lessened by compelling the railroads to suppress smoke in passing through the cities, and, above all, that the hours of the employees be not too long, so that they may give efficient service and stop the sacrifice of life on railways. To compel the railways to do these things is to compel them to benefit themselves and involves no injustice to the stockholder. I do not think we realize yet how serious this step of the federal and state governments is. The great fall in the value of railway shares in England during the past ten years is traceable

YEARLY DIVIDENDS AND PRICES FEBRUARY 1ST, OF EACH YEAR.

	Per Cent	1898	1899	1900	1901	1902	1903	1904	1905	1906	1907
Caledonian	Dividend	5	4¾	4	4	4	3⅞	3⅞	4	3⅝	
	Price	160	156	141	130	126	115	104	112	119	102½
Great Eastern	Dividend	3⅝	3⅞	3	3	3⅛	3¼	3¼	3¼	3⅜	
	Price	120¼	122	123	107	105	94½	87½	89	87½	79½
Great Northern	Dividend	2¼	1¾	0	0	¾	1	1	1½	1¾	
	Price	58¾	63½	56¼	45¼	43	42¾	39¼	39	46	44½
Great Western	Dividend	3⅞	5½	4⅝	4½	5⅞	5⅜	5½	5⅜	5⅜	
	Price	178	167½	167	146½	140	138	137	141	142	130½
Lancashire & Yorkshire	Dividend	5¼	5¼	4⅜	3¾	4	3⅜	3⅜	3¾	4⅜	
	Price	148½	151½	145	131	113	108	96	108½	109	104½
London, Brighton & South Coast	Dividend	6¾	6½	4¼	3½	4¾	4½	5¼	5½	5	
	Price	178½	176¾	171	133½	126	128	105½	128½	130	116
London & Northwestern	Dividend	7⅛	7⅛	6¼	5½	6	5⅞	5¾	6⅛	6⅜	
	Price	204½	203½	197	179	170	168	152	153½	161	153
London & Southwestern	Dividend	6½	6½	6⅛	5⅜	6	6	6	6	5¾	
	Price	232	222½	208	190	174	174	155	160	161	153
Midland	Dividend	3⅜	3⅜	2¾	2⅛	2¾	2¾	2½	2⅝	2¾	
	Price	93	93½	81	75½	75	73	68½	68½	69½	66
North Eastern	Dividend	6½	6⅝	6⅜	5¼	5⅜	5½	5⅜	5½	6¼	
	Price	179	181¼	175	169½	155½	147	139½	139	145¾	145⅜

directly to the power to fix rates placed in the hands of the Board of Trade, a conservative body of practical men in one of the most conservative countries in the world—conservative in the best sense. The English railroads now find themselves confronted with the necessity of making extensive improvements, including the laying of track, with no visible resources for the undertaking. . . . . The consequences of discouraging railroad improvements must be still more serious in America than it has been in England, for the reason that England had her mileage and adequate trackage built when the practice of attacking earnings began.

During the past year the most serious attack on railways has come from the separate states, but it is the new powers conferred on the Interstate Commerce Commission from which we really have most to fear. The cry of the public is always for lower charges. Let this cry come up from all parts of the country to this small body of men through a series of years and what hope is there that they will succeed in withstanding it?

The problem of an emergency currency revolves principally around the question of what constitutes an adequate tax on such currency. Without an adequate tax the currency will not contract sufficiently in normal times and will therefore lack proper elasticity in abnormal times. Furthermore, without such tax there is serious danger that inferior money will take the place of good money. Two things conjointly cause gold to be drawn to a country: One is the providing of a place for gold in the currency system of the country, the other is the interest rate. Neither the one nor the other alone suffices. High rates of interest have obtained in silver countries without drawing gold to them; high rates of interest obtained in the United States before our resumption of specie payments, without sufficiently attracting gold. There must be a need for gold (*i. e.,* a gold standard and an absence of other forms of money), accompanying the high interest rate, otherwise gold will not come. Obviously the way to maintain "an absence of other forms of money" is to tax such money. If we want to prevent an issue of paper money which, if issued, would interfere with the supply of gold, we must begin the tax on such money at a rate which is supposed to attract gold so that the general rate of interest may not be interfered with beyond that point. For example, if the United States, which is on a gold basis, finds that a general interest rate of 6 per cent will attract gold, it can avoid having its gold supply affected by an emergency currency if the tax it imposes upon such currency begin at 6 per cent. A currency taxed at 6 per cent will not be issued until the general rate of interest is high, *i. e.,* until gold is being attracted; and it will not interfere with the continued inflow of gold, because the moment the interest rate falls too low, emergency currency so taxed will become unprofitable and will be withdrawn. On the other hand, currency issued at a low tax is apt to keep the general interest rate too low and prevent the inflow of gold. The advocates of asset currency in this country refuse to consent to the imposition of a tax which would cause their currency to disappear in ordinary times. Asset currency so taxed is not their kind of asset currency.

The question of the basis of the currency issues, whether bank assets or miscellaneous securities deposited with the government, is of minor importance as compared with the question of an adequate tax on the issues. Still, because of the number of banks

in the United States to be surveilled, it seems preferable that the government should have in its own hands something to secure the issues. Coming to the question of the character of the securities to be so deposited, we find objection made to the inclusion of railroad bonds on the ground that the market value of railroad bonds would be unduly enhanced. Is this objection sound? A high market price for the bonds means borrowing at a low rate of interest, or lighter fixed charges on the railroads. Now, whether it be the public purpose to further cheapen the service or to let the railroads earn a profit and insist upon their using it to better the service, a lessening of the burden of fixed charges conduces equally to either end. So that from whatever standpoint we look at it, the inclusion of railroad bonds in the securities to be deposited for emergency currency issues would be a public gain.

The crisis of 1907 was aggravated, as we know, by a run on the banks. Two devices suggest themselves as calculated to prevent a recurrence of this: one, postal savings banks, the advantages of which must be apparent to every student of public questions, the other a guarantee by the federal government of deposits in national banks. It would be a distinct gain if, while having a secure currency, we could at the same time make secure the deposits in national banks. This guarantee could be made without risk of financial loss to the government if a small tax were imposed on the banks the proceeds of which would constitute a guarantee fund, the government being empowered to levy an extra assessment on all the national banks in addition to the regular tax whenever the guarantee fund fell below a specified amount fixed by the statute. The contention that the government would assume an impossible obligation under such a guarantee is met by the provision that the government guarantee be limited to the actual fund collected, as under the Canadian provision for the redemption of the notes of failed banks. Is such a guarantee likely to undermine to any great extent the conservative management of the banks? Certainly it would not relieve the stockholder from responsibility. Before the government guarantee would apply and the government fund be touched, the stockholder would be called upon to make good his extra liability of $100 on every share of stock when the assets were inadequate.

It may be urged that the power to withdraw deposits and make

the bank unprofitable, or actually to threaten its stability, is an instrument the effect of which is immediate, that therefore the depositor in practice exercises a much more effective control over the directors than the stockholder, whose knowledge of the affairs of the bank is notoriously inadequate and whose control of the bank's policy is correspondingly feeble; that the consciousness of this fact acts as a check upon the bank's officers; that if depositors were guaranteed the depositor would no longer scrutinize the management of the bank, the result being looser management and more failures and greater losses to be made good by a government guarantee. To what extent the watchfulness of the depositor makes for conservatism in banking is problematical. Let us assume that all of these contentions are well founded and that at first losses through bank failures would be doubled under this plan. On whom do these losses fall? Not on the depositor, for his deposit is secure under the government guarantee—and the depositor is the public. It falls, first, on the stockholder, who, if bank methods become lax, will soon devise means of keeping better control of the management. It falls, next, on the associated banks whose interest it immediately becomes to insist on more efficient government supervision. Furthermore, one source of bank failures—the run on banks—is removed. With these factors to offset the greater laxness of bank management, which we will assume results from the withdrawal of watchfulness on the part of depositors, it is reasonable to suppose that in the course of a few years the losses through failure of banks would not be greatly in excess of the present average. But even if these losses were doubled a very small tax would still suffice to cover them.

In the extreme case of losses threatening to become excessive, resort could always be had to a repeal of the statute and, after reasonable notice, an abandonment of the government guarantee without jeopardy to existing interests. In other words, the proposed legislation involves no such dangers as lax currency legislation.

Ease of mind of the depositor, actual security from loss on the part of many who can ill-afford a loss, a broadening of the practice of intrusting money to banks instead of hoarding, the entire removal of the incentive to withdraw deposits for hoarding and consequent doing away with runs on banks; these are the advantages that could be confidently expected.

In a discussion of the business depression and possible remedies the question of wages forces itself upon us. It is urged that the laborer should accept lower wages to help along recovery. In many cases he is forced to accept lower wages whether logic is with him or not. In times of business depression his strategic position is particularly weak and his appeal must be principally an appeal to reason. Now, from the standpoint of the public interest, to what extent does a reduction of wages really conduce to recovery, and even though it may so operate, is the public welfare promoted in the long run by such reduction? If the standard of living be lowered by lower wages—and how can it be otherwise—lowering wages is to be avoided, if possible. It is the standard of living which makes not only the market but the man, *i. e.,* makes him a more valuable citizen and more efficient workman. If wages are the last thing to recover with a recovery of business activity and the last thing to advance amid advancing prices, then wages are entitled to especial consideration and protection. Undoubtedly lowering wages helps to lower prices, but in times of depression the extent to which lower prices enlarge the market is problematical. If it be a question of foreign competition, *e. g.,* if lower wages abroad are forcing the manufacturer out of his principal field of operation, the case for lower wages at home is plain. But when a people are surrounded by a tariff wall, it is safe to say that in the long run wages are recovered by the employer in prices, just as taxes in the long run are recovered in prices.

And underlying the whole problem is the question of social justice. Has the laborer since the beginning of the industrial era gotten out of his labor as decent a living as the ingenious labor-saving machinery of modern times should give to him? And is it not fairer that capital and direction should suffer the pinch of hard times before they ask labor to share it?